NOTE FROM THE FILING UTILITIES' PRICING REPRESENTATIVES
December 14, 2001

The revised pricing proposal is attached and distributed for review and comment. The filing utilities' pricing representatives would greatly appreciate if commenters identifying concerns or problems with the proposal also suggest solutions that satisfy the commenter's concern and address the pricing problem identified in the attached draft pricing proposal.

While developing the revised pricing proposal, the filing utilities' pricing representatives realized that the description of the RTO West Transmission Services developed early 2001 (and posted on the RTO West web site February 21, 2001) would need revisions to conform to the emerging congestion management and pricing models. A draft revision has been prepared and this pricing proposal should be read in conjunction with the proposed revisions to the Description of RTO West Service Overview, which are also attached to the PDF file.

Readers should also be aware that the revised pricing proposal was developed contemporaneously with the continued development of the "convergence" congestion management model. Although the pricing representatives endeavored to design a model consistent with the congestion management model, a thorough review and cross-walk between the two proposals is needed. Comments on this subject are encouraged.

DRAFT

RTO WEST PRICING PROPOSAL

December 14, 2001

A. Background: The Pricing Problem

Designing a pricing proposal that permits transmission owners to recover revenues comparable to those currently recovered from transmission uses in order to avoid substantial price increases and cost shifting among loads, while improving market efficiency, has proved challenging. The goals of avoiding cost shifts, eliminating pancaking, and promoting economic efficiency by eliminating volumetric charges (other than load charges) to recover fixed costs have proved very difficult to achieve simultaneously. At various times, participants in the RTO West process have proposed that some of these costs be (1) charged to historical purchasers as transfer and access charges, (2) left with the PTO to recover in its Company Rate, (3) uplifted to be recovered over all schedules or loads, and (4) charged to future users on a "pay as you go" basis. Finding a method to replace historic short term and non-firm revenues has been a particularly vexing problem. In addition, an earlier Stage 2 proposal attempted to reduce the size of the problem by assigning revenues from the sale of transmission rights to offset fixed costs and designing a set of tools to allow the historical purchasers to receive value for their transfer payments. These proposals have met with various criticisms, including cost shifting, disparate treatment according to the type of customer, entities being forced to pay many times the posted price for transmission (at the time they purchased it) because of the continuing transfer charges, entities getting no value for payment made, entities seeking future guarantees based on aberrational short term sales in

2000 and 2001, and certain failure because anticipated revenues are not likely to occur. Although different criticisms apply to different proposals and the degree of validity of the criticisms varies, they, and the many pricing proposals considered, evidence the difficulty of achieving a workable pricing model in an already low-cost region.

Yet, the dilemma persists and must be resolved. Currently, some RTO West participating transmission owners recover a significant amount of revenue from the sale of short term transmission. These short term revenues were $285 million in the year 2000 out of a total gross revenue requirement of $1.6 billion. Thus, short term revenues constituted almost 18% of the PTOs' cost recovery in 2000. In Stage 1, the filing utilities proposed one method to replace these revenues (described below). However, further evaluation of the Stage 1 proposal led to the filing utilities revisiting the method of recovery of short term revenues in Stage 2 . The pricing proposal presented below returns to the traditional notion of requiring all users, including short term users, to pay a pro rata share of embedded costs of the RTO West transmission grid. The evolution of the pricing proposal from Stage 1 to Stage 2 is chronicled below.

1. Stage 1 Background

a. Use of Short Term Transfer Payments to Avoid Cost-Shifting Among Loads

The Stage 1 filing proposed that each transmission owner would pay during the Company Rate period a transfer charge to each of the other transmission owners to replace revenues from short term use. The transfer payment was equal to the representative levels of pre-RTO short term firm and non-firm transmission revenues paid by the participating transmission owners and its affiliates before RTO

West's commencement of operations. (The NWPP participants were to pay an access charge calculated in the same manner.) These transfer payments were not accompanied by the assignment of any transmission rights. Instead, they were made solely to avoid cost shifts among transmission owners. In addition to the transfer payments between transmission owners, the Stage 1 proposal assumed that a transmission owner's affiliate merchants would pay an internal transfer charge for pre-RTO short-term and non-firm transmission service or clear the cost through other internal mechanisms.

During Stage 1, the filing utilities recognized that payment of transfer charges by participating transmission owners and a comparable access charge by other NWPP participants put the owners and NWPP participants at a competitive disadvantage as compared to new entrants and non-NWPP power marketers who would not contribute to the recovery of embedded costs of the RTO West transmission grid. Today these customers pay the same short term and non-firm rates as transmission owners and other NWPP participants. However, in an imperfect world, the filing utilities found the level of transfer payments and access charges tolerable as a means to avoid cost shifting among loads.

During Stage 2, this proposal became unacceptable to the filing utilities for several reasons. Based on 1999 data available during Stage 1, the total short term transfer payments among participating transmission owners was estimated to be $35,655,166. However, by the end of 2000 that amount had increased to $78,278,222. The transfer charges were simply too high a price for loads to pay as a "charge for admission" to the RTO, particularly when one considers that RTO start up and operational costs (estimated at $75 million) would impose additional costs on loads. The filing utilities were concerned that such transfer charges imposed significant state regulatory risks and, in some cases, would substantially threaten RTO approval. In other cases, transmission owners argued that the discrimination against transmission owners and NWPP participants as compared to new entrants was not tolerable given the changed cost estimates, particularly because they would not receive any transmission rights for their payments.

b. Payments of Lost Revenues Recovery Amounts to Avoid Cost Shifts

The Stage 1 filing also proposed that lost revenues would be recovered through the RTO West uplift charge that would be imposed on loads or transactions throughout RTO West. (Short term revenues from customers other than NWPP utilities are referred to as "lost revenues in Stage 1 because these revenues would not be recovered from these customers under Stage 1.) The lost revenues were expected to be offset in part by excess FTR revenues from the auction of certain FTRs. This proposal became unacceptable for two reasons. The lost revenue numbers became much larger than anticipated and there were no offsetting revenues from the sale of FTRs. In 1999, lost revenues were estimated at $12,266,778 and the filing utilities anticipated that the sale of certain transmission assets by Montana Power Company to PP&L Montana would reduce that amount. However, the sale has not been consummated and significant changes in usage patterns on the transmission owners' systems have increased the lost revenues to approximately $43, 326,922 in 2000. Worse yet, lost revenues are estimated to be substantially higher in 2001. Moreover, the filing utilities were unable to make the physical rights congestion management model work and therefore switched to a financial option approach to congestion management during Stage 2. The Stage 2 congestion management model is not expected to produce excess revenues. Consequently, the premise of the Stage 1 pricing model -- that uplifting lost revenues and spreading to all loads would result in a small incremental charge to loads and insignificant cost shifting -- proved to be false.

2. The Stage 2 Proposal to Replace Short term and Non-firm Transfer Payments, NWPP Access Charges, and Lost Revenue Uplift with aTransmission Use Access Charge

The Transmission Use Access Fee proposal is expected to replace the Stage 1 proposals for short term firm and non-firm transmission service transfer charges, NWPP access charges and lost revenue recovery charges. This proposal is based on the concept that transmission service that is not covered by existing long-term transmission agreements or existing load service obligations will pay an access fee for the right to schedule on the RTO West transmission grid. As a result of this fee, all customers using RTO service will pay some portion of the system's embedded costs. Revenues from the Transmission Use access charge will be allocated back to the transmission owners to replace the short-term firm and non-firm revenues that customers pay today. These revenues will also be used to replace revenues from long-term contracts that expire during the Company Rate Period and to insure collection of revenues for use of new transmission facilities built during the transition to the RTO and thereafter. Although each transmission owner will bear some risk of under-recovery as compared to the Stage 1 proposal, the owners also may recover a larger credit against their Company Rate revenue requirements from theTransmission Use access charge revenues. The approach is not dissimilar to the present model where all uses pay some portion of embedded costs and transmission customers using the system on a short term or non-firm basis pay as they go, thereby producing varying revenues to offset rates their loads pay.

B. The Pricing Proposal

RTO West will offer three services: Converted Rights Service, Transmission Use Service and Non-Converted Rights Service. The RTO Pricing Proposal discussed in this section applies to the two new RTO services: Converted Rights Service and Transmission Use Service. Non-Converted Rights Service is discussed infra at ___.

The filing utilities propose to recover all costs of congestion management and ancillary services through separate charges (see sections___ and ___). The RTO start up and operation costs will be collected through a volumetric grid management charge levied on all transactions. The remaining costs of ownership and operation of their transmission facilities will be recovered through two access charges, one for Converted Rights Service and one for Transmission Use Service. The Converted Rights Service access charge, or Company Rate, is load-based and calculated on the basis of each PTOs entire revenue requirement. The Transmission Use access charge is a postage stamp $ per kW year, month or daily charge based on the embedded cost of the RTO West grid. This access charge is treated as a revenue credit against each transmission owner's revenue requirement in rate setting.

1. Company Rate (Load-Based Access Charge for Converted Rights Service)

a. Company Rate

Through December 14, 2011, the loads served by each of the filing utilities will pay a load-based access charge for RTO West transmission service equal to the transmission costs of such filing utility, adjusted for the long-term transfer charges, any non-converted service payments (if a customer is not paying the Company rate) and Transmission Use access charges, as set forth in items b through d below.

b. Transfer Charge for Long-Term Transmission Agreements

Participating transmission owners may convert their pre-existing long-term transmission agreements and take RTO transmission services in return for FTOs of comparable value received from RTO West, or retain their pre-existing transmission rights under long-term agreements. A participating transmission owner that was a transmission customer under such agreements, in turn, would be obligated to pay company rates or transfer charges to the former transmission provider (and, in exchange, would receive FTO rights or service comparable to its pre-RTO firm transmission rights) for such portion of the Company Rate Period as the FTO or pre-existing rights would remain in effect. Any transfer charges will be in agreed amounts comparable to the amounts estimated as payable under the pre-existing agreements absent RTO West. The agreed amounts for long-term transfer payments are specified in exhibit ______. [Note: We will endeavor to finalize transfer payments before March, and then file as part of Stage 2.] Comparable contract suspension arrangements will be offered to all third parties holding agreements for long-term transmission service.

c. Long-term Transfer Charge Adjustment

Long-term transfer charges among the transmission owners generally are not adjustable for changes in loads, as most of the underlying contracts do not allow for an increase in service for load growth.

Transfer charges among transmission owners may be adjusted, however, to the extent the preexisting contract provides transmission service for load growth. Examples of such contracts would be some of the General Transfer Agreements. For converted agreements, additional FTOs on an owner's transmission facilities will be provided for growth of loads served pursuant to these agreements, up to available capacity.

A number of Bonneville customers also expressed concern that the unit costs of Bonneville transmission might substantially increase during the Company Rate Period, without any provision for a corresponding increase in transfer charges. To allay such concerns, the Transmission Operating Agreement permits a participating transmission owner to make an initial election that its transfer charges increase or decrease if its unit transmission costs increase or decrease. For a participating transmission owner so electing, the adjustment: (1) will be made only upon a filing for a change in its company costs; (2) will be based on actual transmission costs during a historical period and pursuant to a formula determined by RTO West; and (3) will apply only to transfer charges for pre-RTO agreements that had adjustable charges.

d. Transmission Use Access Charge

The Transmission Use Access Charge provides access to the RTO West transmission grid, that is the right to schedule megawatts between any pair or pairs of injection and withdrawal points on the grid up to the maximum quantity purchased for a designated time period. For example, if an eligible customer purchases 100 megawatts for a week's duration, that customer may schedule up to 100 megawatts over any combination of injection-withdrawal points each hour of the week. Transmission Use Access rights are offered in strips with the same quantity of megawatt-scheduling rights available each hour.

The Transmission Use Access charge is estimated below. The actual charge will be based on updated PTO revenue requirements and loads used in the calculation of Company Rates. RTO West would adjust the Transmission Use Access charge annually.

The estimated charge for a yearly strip of Transmission Use Access rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{\text{Total 12 CP Loads plus Exports}} \times 0.9$$

$$\frac{\$1{,}590{,}697{,}413}{[\approx 45{,}658 + \approx 4{,}500]} \times 0.9 = \$28.54\ /\text{kW-yr}$$

The estimated charge for a monthly strip of Transmission Use Access rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{[(\text{Total 12 CP Loads plus Exports}) \times 12 \text{ months}]} \times 0.93$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 12 \text{ months}]} \times 0.93 = \$2.46\ /\text{kW-mo}$$

The estimated charge for a weekly strip of Transmission Use Access rights is calculated as follows:

$$\frac{\text{Sum of PTO's Annual Transmission Revenue Requirement}}{[(\text{Total 12 CP Loads plus Exports}) \times 52 \text{ weeks}]} \times 0.97$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 52 \text{ weeks}]} \times 0.97 = \$.592/\ \text{kW-wk}$$

The estimated charge for a daily strip of Transmission Use Access rights is calculated as follows:

<u>Sum of PTOs' Annual Transmission Revenue Requirement</u>

[(Total 12 CP Loads plus Exports) x 365 days]

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 365 \text{ days}]} = \$.087/\ \text{kW-day}$$

The estimated charge for an hourly strip of Transmission Use Access rights is calculated as follows:

$$\frac{\text{Sum of PTOs' Annual Transmission Revenue Requirement}}{(\text{Total 12 CP Loads plus Exports}) \times 8760 \text{ hours}}$$

$$\frac{\$1{,}590{,}697{,}413}{[(\approx 45{,}658 + \approx 4{,}500) \times 8760 \text{ hours}]} = \$\ .00362\ /\text{kW-hour}$$

The above formulas provide incentives to purchase longer term service by providing a 10% discount for annual service, a 7% discount for monthly service and a 3% discount for weekly service.

The customer may assign unused Transmission Use Access rights and RTO West will facilitate a secondary market for resale of the right to schedule. The secondary market price is capped at the applicable access charge paid by the seller (yearly, monthly, daily or hourly) and may be discounted.

If the actual injection and withdraw schedule of the Transmission Use Service incurs congestion costs, the access charge will offset the congestion-clearing charge. The Scheduling Coordinator would be responsible for all congestion costs each hour that exceed the Transmission Use hourly access charge. In the rare event of curtailment of schedules, RTO West will rebate an amount equal to the hourly charge times the quantity of megawatts curtailed.

e. Transmission Use Access Charge Revenue Allocation

Transmission Use Access revenue will be:

total revenues from the sale of Transmission Use Access Service, less the amount used to offset congestion payments.

Revenue generated through the application of the Transmission Use Access Charge to a PTO's merchant affiliated with a participating transmission owner, for transactions that could have been accommodated pre-RTO by using only its own system, will be allocated to that owner. Transactions by the affiliated merchant that would require the use of other system(s) will be allocated based on the methodology below.

Other revenue generated through the application of the Transmission Use Access Charge will be allocated among the participating owners based on each PTO's relative share of the sum of the following:

(1) Reference Year Short Term Transfer Payment receipt amounts (PTO to PTO short-term, NWPP and Lost Revenues);

(2) Revenues that would have been received through the application of Reference Year transmission rates to (actual post-RTO) transactions over transition capacity. Only count revenue in excess of that (if any) included in 1 and 2, above over the transition capacity. Transition capacity is capability of facilities completed after ______ that is not being used to serve load obligation or for internal merchant use.

[Drafters' Note: The Reference Year may be one year, such as calendar year 2000, or an average of several years.]

f. Comparison of RTO West Transmission Use Service with Traditional (OATT) PTP Service

1. Traditional Point to Point Service

Traditional Point to Point (PTP) service allows parties to purchase transmission service between specific primary points of integration (POI) and specific primary points of delivery (POD). While traditional PTP customers have rights to use secondary POIs and PODs on the transmission owners system, i.e, Bonneville's system, these rights are on a lowest priority non-firm basis. Prior to the RTO commercial operations, schedules over secondary PTP rights were simply cut if there was insufficient transmission available to accommodate the schedules.

2. RTO West Transmission Use Service

RTO West Transmission Use Service is different than the traditional PTP service in a number of respects. The RTO West Transmission Use Service is infinitely flexible to the extent that there is transmission made available through redispatch or transmission expansion. An RTO West Transmission Use Service customer has the right to schedule between any pair or pairs of injection and withdrawal points on the RTO West transmission grid up to the maximum quantity purchased for a designated time period, annual, monthly, weekly daily or hourly.

The RTO West Transmission Use Service is similar to the traditional PTP service secondary rights in that it can be used between multiple pairs of injection and withdrawal points and is subject to congestion costs, but different in that it is not limited to service to a specific transmission owners system and is not the lowest priority non-firm service. It is also only subject to congestion costs only to extent that congestion costs exceed the Transmission Use charge.

g. Converted Rights Service

Converted Rights Service is service converted from existing pre RTO contractual (PTP or Network) or Load Serving Obligations on PTO transmission systems. Transactions consistent with the existing pre RTO rights are covered by Converted Rights Service. In order to schedule other transactions the RTO will require the purchase of Transmission Use Service. For example, if a customer converts a network contract to RTO service, then a schedule from its Network Resources to its load would be Converted Rights Service. However, service from other resources to its load or from Network Resource to an off system withdrawal point would require purchase of Transmission Use Service.

h. Grid Management Charge

The Grid Management Charge will be calculated to recover all the RTO West start up and operation costs, including the annual costs of RTO facilities not included in Company Costs and RTO West operating costs (other than the costs of clearing congestion and providing ancillary services). The GMC will be paid on a $/Mwh basis for all schedules (whether from generation within the RTO West Transmission System or imports or through wheeling) and is applied at the Point of Injection on the RTO West Transmission System.

C. RTO West Losses Methodology

RTO West proposes a bifurcated method to recover losses through the Company Rate Period.

1. For non-converted contracts, continue to charge loss factors of the existing participating transmission owners.

Because this is non-converted contract service, the RTO would know which participating owner's system is being used by each schedule, and would charge the customer the participating owner's individual loss factor(s). This methodology is included in the RTO West filing as part of the pricing proposal agreed to through December 14, 2011, the end of the Company Rate Period.

This methodology assures existing rights holders that the RTO losses methodology will not produce cost shifts for their non-converted contracts.

2. For converted service and new service the filing utilities will not develop a specific losses methodology prior to selection of the independent RTO West Board. Instead principles have been developed to guide the board in developing a losses methodology and the principles will be specified in the participating owners' agreements with the RTO. The primary rationale for this approach is that little work has been done to date on a losses methodology, making it very unlikely that a methodology could be developed in time for the March filing, given the complexity involved.

The principles to guide the RTO's development of a losses methodology are:

- Avoid cost shifts
- Recover actual losses
- Allow the customer to choose between providing losses (concurrently) and buying losses at

the imbalance price

- Eliminate pancaking
- Send appropriate price signals about resource/load location and operation
- The customer should know the loss factor associated with a particular transaction before submitting a schedule. Loss factors should not be computed after the fact.

The loss methodology proposed by RTO West will be subject to review and approval by the Commission.

Pricing Caucus Proposed Revisions

Description of RTO West Service

Overview to be Inserted in Tariff Part I Section 2

RTO West offers two categories of services -- Transmission Services and Ancillary Services -- upon terms and conditions set forth in this Tariff. The descriptions of Transmission Services set forth in Parts II through V of this Tariff define each service to be offered by RTO West. Ancillary Services are described and their terms and conditions set forth in Part VI. The "Common Service Provisions" in this Part I set forth terms and conditions common to all the services. This section is intended to provide an overview of the types of Transmission Services offered by RTO West in general language. In the event of any conflict between the general language in this section and the terms and conditions of service set forth in Parts II-V below, the terms and conditions of service shall prevail.

[Drafters' Note: TOA definition of "Transmission Services" states that "Ancillary Services" are not included within "Transmission Services."]

[Drafters' Note: Are common service provisions relevant to Ancillary Services or only Transmission Services?]

RTO West will offer two primary services, Converted Rights Service and Transmission Use Service. In addition, RTO West will provide Non-Converted Service to non-converted contracts and pre RTO West load serving obligations. These transmission services are available to Eligible Customers of RTO West; however, all scheduling must be through a Scheduling

Coordinator. Scheduling Coordinators using these transmission services must pay Congestion Costs (or provide appropriate congestion hedges) when scheduling over congested paths. Congestion costs can be hedged with Financial Transmission Options (FTOs). FTOs can be obtained based on pre-existing rights, purchased on the secondary market, or purchased from periodic RTO auctions.

Two other services -- Generator Interconnection and Integration Service and Load Integration Service -- provide, respectively, the physical right to integrate power into the RTO West grid, or integrate power from the grid into distribution systems for consumption by loads. These services do not provide use of the RTO West transmission grid to move power. Transmission services to move power – either Converted Rights Service, Transmission Use Service or Non-Converted Service must be acquired separately.

Generator Interconnection and Integration Service permits generators to physically interconnect with the RTO West transmission grid and obtain from RTO West the right to put power on the RTO West grid. Generators interconnected with non-RTO West transmission facilities [of Participating Transmission Owners/ within the RTO West grid] must acquire Generation Integration Service in order to obtain the right to put power on the RTO West grid. Generators must execute an integration agreement with RTO West setting forth operational requirements for safe and reliable integration of the output of a generator into the RTO West grid. Generators will pay direct costs associated with interconnection as set forth in Part ___. Once a generator is interconnected with a Participating Transmission Owner's transmission facilities and its output integrated into the RTO West transmission grid, Converted Rights Service, Transmission Use Service, or Non-Converted Rights Service may be used to move power from that generator to loads within the RTO West transmission grid or off-system, and a Scheduling Coordinator may schedule power from that generator on behalf of any Transmission Customer.

Load Integration Service permits loads interconnected to transmission or distribution facilities within the RTO West grid to establish the safe and reliable integration of a load to the RTO West transmission grid and the right for that load to take delivery of power (energy and capacity) for consumption by the load. Loads interconnected with the transmission facilities of Participating Transmission Owners must acquire this service in order to obtain the right to use the grid to deliver power for consumption by their loads. Once a load is integrated into the RTO West transmission grid, Converted Rights, Transmission Use or Non-Converted Rights Transmission Service may be used to move to that load and a Scheduling Coordinator may schedule power from on or off system to serve that load on behalf of any Transmission Customer.

Converted Rights Service provides transmission service to loads within the RTO West grid from designated resources or injection points to any of the designated withdrawal points. Service to a Converted Rights customer from points elsewhere on the RTO grid requires Transmission Use Service as well as Converted Rights Service.

Transmission Use Service provides transmission service from any injection point to any withdrawal point on the RTO West Grid. Injection and withdrawal points may vary from hour to hour. Transmission Use Service may be purchased in hourly, daily, monthly, and annual blocks or strips of contiguous rights, with the same quantity of scheduling rights in each hour. Because FTOs are a congestion-clearing hedge and independent of Transmission Use Service rights, the RTO will not limit the amount of Transmission Use rights sold. The customer may assign unused Transmission Use access rights. Transmission Use access rights must be obtained for all schedules not covered by Converted Rights or Non-Converted Rights Service.

Non-Converted Rights Service provides Participating Transmission Owners with transmission service necessary to fulfill the owners' obligations to their customers under pre-existing contracts or load serving obligations that the customer has not converted to RTO service. Non-Converted Rights service is limited to the terms, conditions, amount of transmission capacity and use of facilities identified in the pre-existing contract.

[Drafters' Note: Revisit this write up after the pricing and congestion management models are finalized and the Tariff definitions of services are completed.]

[Drafters' Note: The TOA contemplated that PTOs would amend their OATTs to provide that transmission contracts entered in after a specified date include a right exercisable by either party to such Transmission Agreement or by RTO West to replace such service with an RTO West service. See Section 5.4.2 of the TOA. The filing utilities are considering when to amend their OATT to provide the right to convert to RTO service other than Non-Converted Rights Service. One proposal is for all filing utilities to file OATT amendments within sixty days of FERC's approval of the filing utilities' petition for a declaratory order that RTO West satisfies all the characteristics and functions of an RTO.

[Drafters' Notes: These services are subject to FERC's review and approval, based on a finding that such services are consistent with Order 2000.]